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RUEHRC/DEPT OF AGRICULTURE USD FAS
RUCPDO/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
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UNCLAS SECTION 01 OF 02 CARACAS 000291

SIPDIS

SENSITIVE
SIPDIS

TREASURY FOR KLINGENSMITH AND NGRANT
COMMERCE FOR 4431/MAC/WH/MCAMERON
NSC FOR DTOMLINSON
HQ SOUTHCOM ALSO FOR POLAD

E.O. 12958: N/A

TAGS: [ECON](#) [VE](#)

SUBJECT: OUT OF THE GATE INFLATION SURGES

REF: A. 06CARACAS 3500

[1](#)B. CARACAS 216

[1](#)1. (SBU) SUMMARY: Inflation grew 2 percent in January 2007, the second highest monthly rate in more than a decade. Prices for foodstuffs (food and non-alcoholic beverages) grew even faster at around 4 percent, and have risen 31.1 percent for the 12 months ending in January. BRV officials announced February 6 that the BRV would soon come out with an "anti-inflation pact." Any serious monetary measures or fiscal tightening to reduce inflation are unlikely for now, because the political costs would be too high. BRV attempts to punish suppliers and merchants for raising prices will only exacerbate existing economic distortions, which are already forcing many importers to either use the parallel exchange rate or stop importing goods. Shortages are becoming common as these economic distortions begin to be felt by the general population. END SUMMARY.

INFLATION, WHAT IS IT GOOD FOR?

[1](#)2. (U) According to the Venezuelan Central Bank (BCV), the consumer price index (IPC) rose 2 percent in January of 2007 and foodstuffs (food and nonalcoholic beverages) rose 4 percent. With January inflation, prices in Venezuela have risen 18.4 percent in the last 12 months and the cost of foodstuffs has risen 31.1 percent. January is typically a month of low inflation in Venezuela, since consumer spending drops following the Christmas season and many businesses remain closed for the first couple weeks of the year. The sharp increase presages further price increases in 2007.

[1](#)3. (SBU) Venezuela's 2007 Budget assumes an annual inflation rate of 12 percent, but given current trends this seems wildly optimistic. Economic contacts are forecasting inflation estimates that range from 20-30 percent this year, and argue that there is little the government can do to limit this growth, given continued high levels of spending and below-inflation interest rates. Both the spending and interest rates are products of political decisions to maintain support for the BRV. According to the economic consultancy EcoAnalitica, the BCV's ability to sterilize government spending is also increasingly limited.

[1](#)4. (SBU) The BCV has been issuing CDs to banks to soak up the

excess liquidity in the economy (note: M2 grew 66 percent in 2006 and 150 percent during the last two years. end note). There are approximately USD 15.5 billion in outstanding CDs, on which the BCV pays 10 percent interest annually. Payment for these CDs comes from income earned on the country's foreign exchange reserves, currently invested in gold (which pays little to no return), and on U.S. and European securities. As the government continues to diminish the country's foreign exchange reserves by transferring them to the National Development Fund (FONDEN), the amount of interest income decreases, limiting the number of CDs that the BCV can issue without losing money, even as the government continues to create more money (i.e., through the transfer of funds to FONDEN some of which are turned back into bolivars). Based on rough Embassy estimates, when the BCV transfers the first tranche of excess reserves this year to FONDEN, roughly USD 7-8 billion, its operations will go into the red (FX reserves are around USD 36 billion). In Venezuela the BCV can be supplemented by the national budget, however it remains to be seen if the BRV is willing to subsidize the Central Bank.

FOOD PRICES SKYROCKET AS SOME PRODUCTS DISAPPEAR

15. (SBU) The rising cost of foodstuffs has alarmed Chavez and many BRV officials, whose supporters in the D and E classes spend most of their incomes on food. Chavez took advantage of his weekly television program, "Alo Presidente" on January 28 to lament the country's inability to meet many agricultural production goals, including for beans, cotton, soy, sunflowers and peanuts. On February 3, Vice President Jorge Rodriguez attended an event sponsored by the

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government-subsidized Mercal food chain, where he listed a range of sales figures and exclaimed that there are no shortages in Venezuela (septel). Other BRV ministers subsequently contradicted Rodriguez, accurately noting that shortages exist and blaming hoarders and speculators for causing the shortages. The Venezuelan tax authority, SENIAT, has setup a commission to investigate "over-pricing" and its superintendent, Jose Vielma Mora, frequently attacks the "speculators" and "hoarders" that are causing inflation and shortages (reftel B). There are on-going shortages of sugar, which has a price set by the BRV below the costs of production, and recurring shortages of a host of other products which disappear and reappear with increasing frequency (reftel A). According to the polling firm DataAnalysis, between 30 and 40 percent of the goods sought by a consumer are unavailable on any given day.

16. (SBU) Other products in short supply are beef and poultry, which disappeared from store shelves this week after the BRV shuttered the Unicasa supermarket chain (which is also the closest store to the Embassy) for selling these goods at prices above those set by the government. Rather than lowering their prices and accepting large losses, the chains decided to leave their shelves bare by withholding products. This led to panic in Caracas and the local "King of Las Mercedes" butcher apparently locked his doors and shut off his phones after one too many frantic member of the Caracas elite called in desperate search of meat. The government is currently negotiating with supermarket representatives and plans are to import meat from Bolivia and Argentina and sell it to distribution centers at subsidized prices, which would then allow these chains to sell at the approved price without a loss. Jose Luis Betancourt, the President of the umbrella Chamber Fedecamaras spoke out against the government-caused economic distortions on February 8, accusing the BRV of precipitating the crisis to provide an excuse to take over private sectors of the economy. He also correctly observed that relying on imports "limits the possibility to add value and generate employment..."

17. (SBU) Well known local economist and commentator Orlando Ochoa claims that up to 25 percent of Venezuelan imports are purchased using money obtained from the parallel market; government officials claim the figure is no more than 5 percent. Many firms now price their goods based on the parallel rate (currently over 4000Bs./dollar, 86 percent above the 2150Bs/USD official rate), or an average of the official and parallel rates.

18. (SBU) COMMENT: Venezuela had the highest inflation rate in the hemisphere in 2006, and inflation shows no signs of abating in 2007. Retrograde government policies continue to cause economic distortions, many of which are manifested in the inflation rate. The government's wrong headed attempts to "alleviate" this problem through price controls and heavy handed tactics only make things worse. The normally pro-Chavez "Daily Journal" noted this week that "people are not necessarily anti-social freaks" when they stock up on available goods in a climate of shortages. Inflation and shortages have the potential to eat away at support for the Bolivarian "Revolution," a fact which Chavez seems keenly aware. What he and his government seem to not understand is that they are treating the symptoms rather than the cause, a method that has only been possible until now due to massive government spending made possible by windfall oil revenues.
END COMMENT.

BROWNFIELD